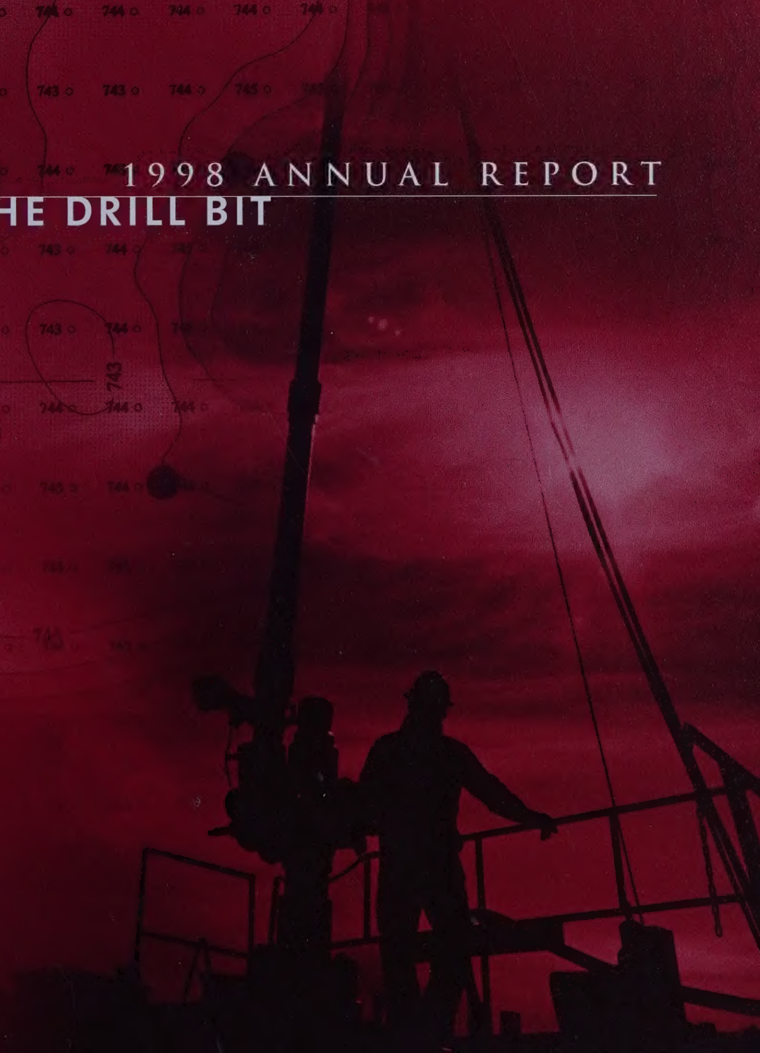
ARRIVAL ENERGY LTD.

1998 ANNUAL REPORT

GROWTH THROUGH THE DRILL BIT



Corporate Profile

Arrival Energy Ltd. is an emerging Canadian oil and gas exploration company based in Calgary, Alberta. Incorporated November 12, 1996 Arrival became a public company in June 1997 through the completion of an $8,200,000 public flow-through share issue. The year ended December 31, 1998 completed the first full year of operations for the Company. Arrival's objective is to increase shareholder value by adding new reserves and production through successful exploration and development drilling. To achieve these objectives, Arrival's primary operating strategies are based on developing and applying technical expertise, maximizing operating efficiencies and adhering to cost controls in the head office and field operations. The Company enters 1999 with no bank debt and a rapidly expanding cash flow with which to conduct its ongoing, internally-generated programs. The Company will continue to pursue a balanced program of exploratory and low risk prospects offering high rewards and maintain high working interests with the opportunity to expand Company operations.

Arrival Energy Ltd. Class A and Class B shares trade on The Alberta Stock Exchange under the symbols ARR.A and ARR.B.

Contents

Annual Meeting

The Annual General Meeting of the shareholders of Arrival Energy Ltd. will be held on June 11, 1999 at 9 a.m. in the offices of Burstall Ward located at Suite 3100 Home Oil Tower, 324-8th Avenue S.W., Calgary, Alberta. All shareholders are encouraged to attend.

1998 Highlights

FINANCIAL	1998	1997
Gross Production Revenue	$ 1,999,000	$ 65,000
Cash Flow From Operations	$ 786,000	$ 71,000
Net Income (Loss)	$ (11,000)	$ 19,000
Capital Expenditures	$ 5,577,000	$ 4,349,000
Working Capital (Deficiency)	$ (1,140,000)	$ 3,567,000
Bank Debt	NIL	NIL
Shares Outstanding at Year End		
Class A	4,460,333	4,370,000
Class B[(1)]	762,600	762,600
OPERATING		
Exit Production (boe/day)	680	187
Average Production		
Crude Oil (bbls/day)	346	15
Natural Gas (mcf/day)	492	–
Barrels of Oil Equivalent (boe/day)	395	15
Average Selling Prices		
Oil ($ per bbl)	$ 12.34	$ 11.87
Natural Gas ($ per mcf)	$ 2.45	–
Reserves		
Proven		
Oil and NGLs (mbbls)	704.4	n/a
Natural Gas (mmcf)	6,041.1	n/a
Barrels of Oil Equivalent (mboe)	1,308.5	n/a
Proven and Probable		
Oil and NGLs (mbbls)	929.9	n/a
Natural Gas (mmcf)	6,323.4	n/a
Barrels of Oil Equivalent (mboe)	1,562.2	n/a
Undeveloped Land (acres)		
Gross	17,020	4,455
Net	12,000	3,132
Wells Drilled		
Gross	10	14
Net	6.2	6.7
Success Rate	92%	69%

(1) Class B shares are convertible to Class A shares. The number of Class A shares obtained upon conversion will be equal to $10 divided by the greater of $1 and the current market price of the Class A shares.

President's Message

On behalf of the Board of Directors it gives me great pleasure to present the results of a very successful year ended December 31, 1998 - our first full year as an operating oil and gas company.

During 1998 Arrival continued to focus on managing the initial flow-through financing in a conservative and prudent fashion while maintaining our objective of creating value for our shareholders. To meet this objective, we have carefully analyzed and selected from the opportunities available in our industry today. Management's plan involves a systematic approach to selecting strategies for long-term profitable growth and maximizing the return to shareholders.

The following financial and operational highlights reflect the success of this strategy over the past year.

- Oil and gas sales rose to $1.999 million in 1998 from $65,000 in 1997;
- Cash flow increased to $786,000 compared to $71,000 in 1997;
- Oil production increased to an average 346 bbls per day versus 15 bbls per day in 1997;
- Gas production increased to an average 492 mcf per day from no gas production in 1997;
- Oil proven plus probable reserves were established at 930 mbbls while natural gas proven plus probable reserves were set at 6.3 bcf;
- 10 wells were drilled resulting in six oil wells (3.8 net) and three gas wells (1.9 net), and
- Net undeveloped land holdings increased 283 percent to 12,000 net acres in 1998.

The past year saw tremendous change for the oil and gas industry worldwide, as the abruptness and severity of the decrease in crude oil prices put the industry into disarray. This event was also catastrophic for the service sector and for many oil producers, particularly those with high debt repayment schedules.

There is, however, a very positive aspect to oil prices falling to 12-year record lows. The oil and gas industry is at the bottom of a cycle, creating opportunities for capable and financially strong companies.

A very active exploration and development program totaling $5.6 million in capital expenditures, significantly increased Arrival's asset base during fiscal 1998. Since inception, the Company has spent $9.9 million to add 1.44 mmboe of proven plus risked probable reserves for an average finding cost of $5.69 per boe, excluding $1.7 million in undeveloped land and related seismic costs.

Throughout 1998, Arrival was successful in diversifying its production and reserve profile so that by the first quarter of 1999, the Company was nearly balanced between oil and natural gas.

Arrival achieved outstanding growth in its reserve base, production base and cash flow during fiscal 1998. This has allowed the Company to position itself for another year of excellent growth in 1999 as the Company's cash flow will enable it to pursue an active exploration and development program. The presently unused line of credit of $5.0 million allows the Company to actively seek acquisition opportunities that complement Arrival's overall growth in 1999 and future years.

CORPORATE OUTLOOK

Arrival's management believes in the long-term viability of the Canadian oil and gas industry. World oil prices are expected to remain volatile in the foreseeable future, with lower product prices continuing to reduce cash flow and competition for assets and services. However, management sees this environment as a window of opportunity to manage capital spending conservatively while finding new reserves at attractive prices.

Arrival will spend approximately $4.0 million on its 1999 exploration and development program, targeting attractive farm-in opportunities and land purchases. These programs will be funded primarily from cash flow and existing credit lines. At the same time, Arrival will strive to maintain low finding costs and will continue to monitor and reduce operating costs. The capital expenditure program will emphasize a balanced production and reserve base of light oil and natural gas. We will continue to operate the majority of the wells we participate in, in order to control the costs and timing of capital expenditures.

ARRIVAL ENTERS 1999 AS A VERY STRONG, WELL-FINANCED EMERGING OIL AND GAS COMPANY. ARRIVAL CURRENTLY HAS NO BANK DEBT AND HAS AVAILABLE A $5.0 MILLION LINE OF CREDIT.

I would like to take this opportunity to thank all Arrival management and staff, our Board of Directors and our shareholders for their ongoing support, dedication and hard work in helping to provide us with a base on which to build a viable and successful oil and gas company.

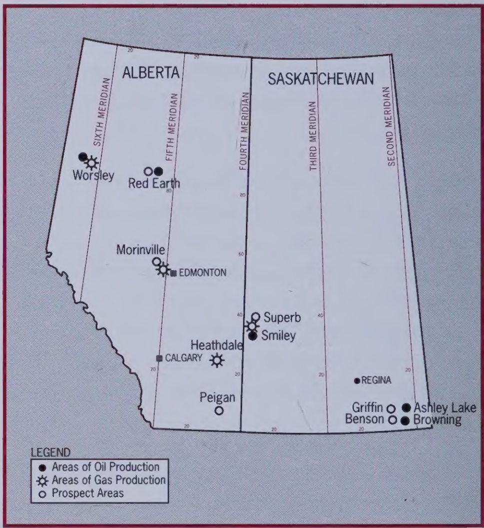
On behalf of the Board of Directors,

Andrew W. Kramchynski
President and Chief Executive Officer
April 19, 1999

Operations and Exploration Review

PRINCIPAL PRODUCING AREAS

Arrival's major properties are concentrated within four principal areas of the Western Canadian Sedimentary Basin in the provinces of Alberta and Saskatchewan. The principal capital focus has been exploration and development drilling of high quality reservoirs within these major areas which have provided Arrival with a well balanced portfolio of operated, producing properties as well as exploration and development prospects for future growth.

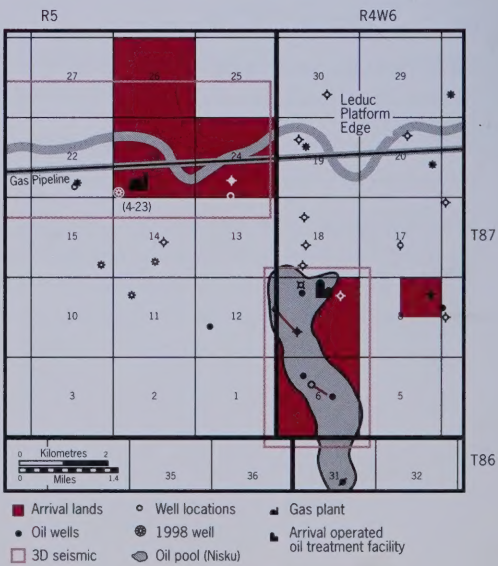


During 1999, the Company will continue to operate the majority of its prospects, each of which will have at least a 50 percent working interest. Arrival's 1999 capital expenditure program of $4.0 million will be continuously monitored against the industry's current high cost and volatile commodity price environment and will be adjusted as external factors require in order to meet Company objectives.

PEACE RIVER ARCH, NORTH WEST ALBERTA

Worsley

Arrival entered this area through an acquisition in July 1998, that provided 35 bbls per day of oil production and associated facilities. The Company operates four 100 percent working-interest oil producing wells that are tied into the Company-operated treating facility. The property currently produces approximately 50 bbls per day of light, high quality (38° API) oil. A three-dimensional seismic program was completed on this property during late 1998 and further drilling is anticipated in 1999.

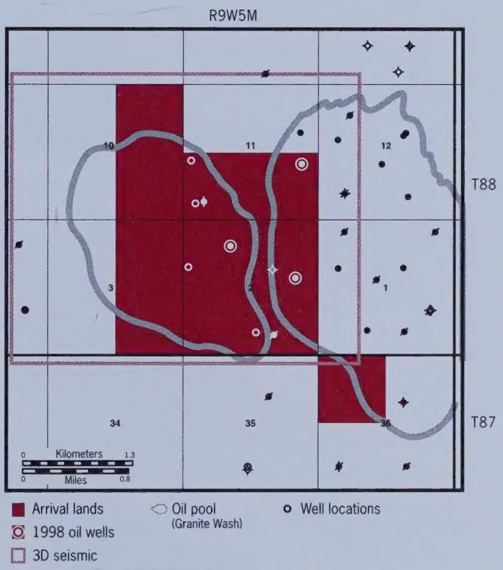


In late 1998, Arrival drilled a new pool wildcat discovery well of sweet gas and liquids rich condensate at 4-23. The well is expected to be tied in prior to spring break-up, 1999 at approximately 3.0 mmcf per day, with 25 bbls of condensate per mmcf of gas. Arrival has a 50 percent working interest in this northern block and operates the exploration phase. A second location has been identified and will be drilled in early 1999.

NORTH CENTRAL ALBERTA

Red Earth

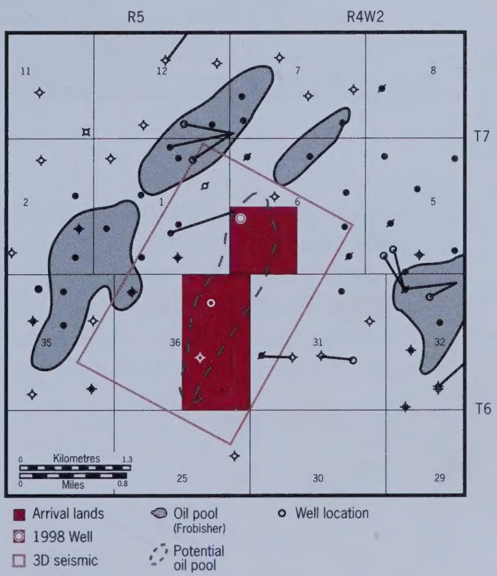
Arrival operates and has a 70 percent working interest in 2.75 sections of land in the Red Earth area of North Central Alberta. At the end of 1998 Arrival was producing approximately 140 bbls per day of light (38° API) quality crude oil from the Granite Wash zone. In the first quarter of 1999, two wells were drilled resulting in two cased oil wells producing a combined 300 (210 net) bbls per day. Further drilling potential exists at Red Earth and will be evaluated in 1999.



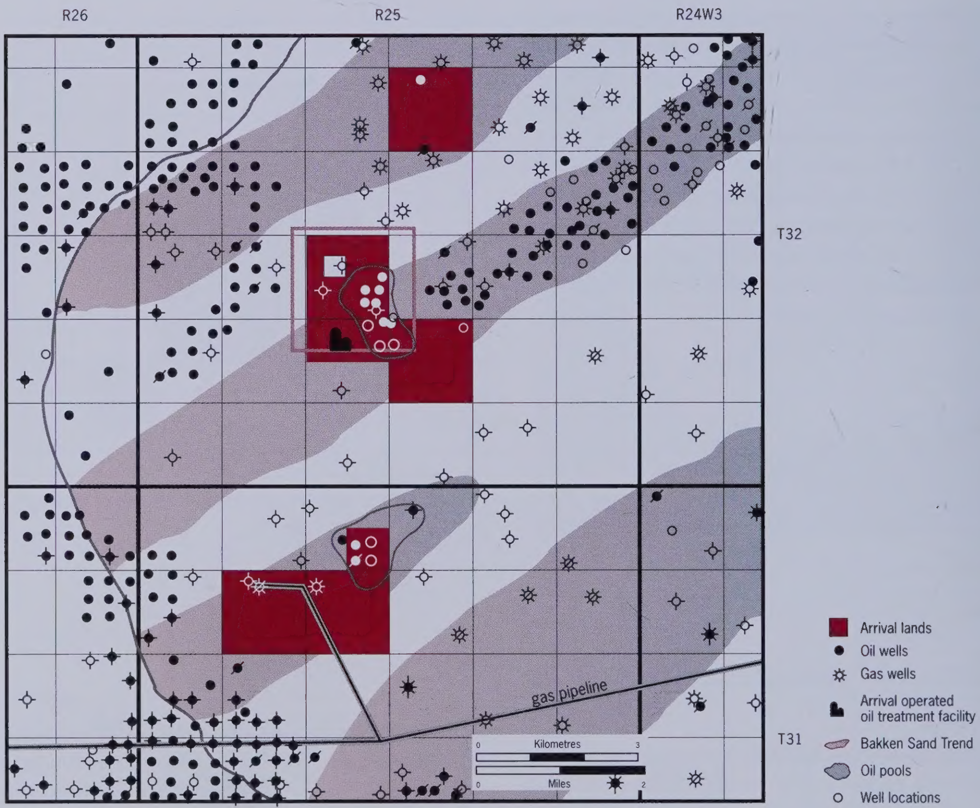
SOUTH EAST SASKATCHEWAN

Browning

Arrival's South East Saskatchewan area includes the Browning property that exited 1998 producing approximately 60 bbls per day of light (35° API) quality crude oil net to the Company. The primary zone of production is the Frobisher within the Mississippian formation. The Company holds a 65 percent working interest in this area and operates the production. Further drilling is anticipated during 1999 to further develop the area.



WEST CENTRAL SASKATCHEWAN



Smiley

The Smiley area of West Central Saskatchewan includes production from shallow (3,000 foot) multi-zone horizons, primarily from the Mannville, Detrital and Bakken zones. The Company has an average working interest of approximately 50 percent in 5.75 sections in this area and operates a central oil treating facility and all wells. Production from the Smiley area is currently 100 bbls per day of heavy oil (16° API) and 650 mcf per day of gas net to the Company. Arrival's lands hold considerable promise for additional drilling and eventually a waterflood of the heavy oil pool will be developed.

Management's Discussion and Analysis

Management's Discussion and Analysis of Arrival's financial position and results of its operations should be read in conjunction with the financial statements presented in this Annual Report.

OVERVIEW

During 1998, Arrival's growth was the result of successful exploration and development drilling, following our strategy of growth through the drill bit. While Arrival exited 1997 with all heavy oil production, 1998 drilling focused on light oil and natural gas, and consequently production will be nearly balanced between oil and gas by the first quarter of 1999. Arrival plans to maintain a balanced production and reserve base in order to weather commodity price fluctuations. As a result of the successful drilling program and despite weak oil prices throughout 1998, Arrival has achieved a strong financial position by increasing cash flow and continuing to focus on cost control.

LAND

Net undeveloped land holdings increased 283 percent to 12,000 net acres in 1998, with significant additions in Alberta at Peigan, Morinville, Red Earth and Worsley. Arrival's objective is to maintain a high working interest and operatorship of acquired lands. This undeveloped acreage provides Arrival with numerous drilling opportunities that will be pursued within the 1999 capital budget and beyond.

UNDEVELOPED LAND
(net acres)

Land expenditures totaled $654,000 in 1998 compared to $562,000 in 1997. Arrival intends to extend the land base in core areas throughout 1999 with property acquisitions and through Crown land sales, maintaining a balance between oil and natural gas opportunities.

UNDEVELOPED LAND HOLDINGS

	1998			1997		
(Acres)	**Gross**	**Net**	**WI%**	Gross	Net	WI%
Alberta	**11,540**	**9,360**	**81%**	2,055	1,612	78%
Saskatchewan	**5,480**	**2,640**	**48%**	2,400	1,520	63%
Total	**17,020**	**12,000**	**71%**	4,455	3,132	70%

DRILLING

Arrival participated in the drilling of 10 wells (6.2 net) in 1998. During the year four wells were drilled in South East Saskatchewan, resulting in three successful oil wells and one abandoned well. Three successful oil wells were drilled at Red Earth, Alberta. Two successful gas wells were drilled in Morinville and Worsley, Alberta and one in the Superb area of Saskatchewan. The 1998 drilling activity resulted in an overall net success rate of 92 percent.

DRILLING ACTIVITY

	1998		1997	
Year ended December 31	**Gross**	**Net**	Gross	Net
Oil wells	**6**	**3.8**	7	3.3
Natural gas wells	**3**	**1.9**	3	1.3
Dry holes	**1**	**0.5**	4	2.1
Total wells	**10**	**6.2**	14	6.7
Success rate		**92%**		69%

RESERVES

Arrival's petroleum and natural gas reserves have been evaluated as at December 31, 1998 by Paddock Lindstrom & Associates. A successful drilling program resulted in a strong reserve base that is almost evenly divided between oil and natural gas reserves on a proved basis. Based on Arrival's exit production rate of 680 boe per day, the reserve life on a boe basis is 5.3 years for proved reserves and 5.8 years for proved plus one-half probable reserves.

RESERVES

	Oil		Natural Gas		NGL	
December 31, 1998	Gross (mbbls)	Net (mbbls)	Gross (mmcf)	Net (mmcf)	Gross (mbbls)	Net (mbbls)
Proved producing	615.0	475.3	1,936.4	1,469.8	–	–
Proved non-producing	–	–	4,104.7	3,095.4	89.4	65.1
Total proved	615.0	475.3	6,041.1	4,565.2	89.4	65.1
Probable	225.5	181.3	282.3	219.0	–	–
Total proved plus probable	840.5	656.6	6,323.4	4,784.2	89.4	65.1
50% reduction for risk	(112.7)	(90.6)	(141.1)	(109.5)	–	–
Proved plus risked probable	727.8	566.0	6,182.3	4,674.7	89.4	65.1

NET PRESENT VALUE BEFORE INCOME TAX DISCOUNTED AT

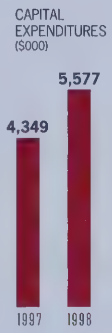
December 31, 1998	0% ($ 000)	10% ($ 000)	15% ($ 000)	20% ($ 000)
Proved producing	8,242.7	5,994.9	5,324.9	4,813.5
Proved non-producing	7,614.8	5,063.7	4,345.1	3,816.1
ARTC	1,650.9	1,251.7	1,125.0	1,025.7
Total proved	17,508.4	12,310.3	10,795.0	9,655.3
Probable	2,725.7	1,559.4	1,278.4	1,083.4
ARTC	212.6	154.6	137.9	125.0
Total proved plus probable	20,446.7	14,024.3	12,211.3	10,863.7
50% reduction for risk - reserves	(1,362.8)	(779.6)	(639.1)	(541.6)
50% reduction for risk - ARTC	(106.3)	(77.3)	(68.9)	(62.5)
Proved plus risked probable	$ 18,977.6	$ 13,167.4	$ 11,503.3	$ 10,259.6

CAPITAL EXPENDITURES

Since inception, the Company has spent $9.9 million to add 1.3 mmboe of proved reserves and 1.4 million of proved plus probable (risked 50 percent) reserves. Capital expenditures of $9.9 million resulted in an average finding cost of $7.59 per boe for proved reserves and $6.92 per boe for proven plus probable (risked 50 percent) reserves. Cumulative capital expenditures to December 31, 1998 include $1.7 million in undeveloped land and related seismic costs.

CAPITAL EXPENDITURES

($)	**1998**	1997	TOTAL
Drilling and completions	**3,571,000**	2,516,000	6,087,000
Production facilities and well equipment	**870,000**	255,000	1,125,000
Land	**654,000**	562,000	1,216,000
Acquisitions (net)	**(193,000)**	600,000	407,000
Seismic	**654,000**	377,000	1,031,000
Other	**21,000**	39,000	60,000
Total capital expenditures	**5,577,000**	4,349,000	9,926,000



FINDING AND DEVELOPMENT COSTS

	Cumulative 1998
Capital expenditures ($ 000)	**9,926.0**
Proven reserves added (mboe)	**1,308.5**
Proven and 50% probable reserves added (mboe)	**1,435.4**
Average cost ($/boe) (proven)	**$ 7.59**
Average cost ($/boe) (proven and 50% probable)	**$ 6.92**

NET ASSET VALUE

		Discounted at	
($ thousands)	10%	15%	20%
Present value of reserves, before income taxes, risked as to 50% for probable reserves	$ 13,167.4	$ 11,503.3	$ 10,259.6
Value of undeveloped land	1,700.0	1,700.0	1,700.0
Working capital (deficiency)	(1,140.0)	(1,140.0)	(1,140.0)
Bank debt	–	–	–
Net asset value	$ 13,727.4	$ 12,063.3	$ 10,819.6

SUMMARY OF OPERATIONS

Year ended December 31 Production	1998 395 boe/day (000's)	 ($/boe)	1997 15 boe/day (000s)	 ($/boe)
Petroleum and natural gas revenues	**$ 1,999**	**$ 13.87**	$ 65	$ 11.87
Royalties (net of ARTC)	**(264)**	**(1.83)**	(8)	(1.46)
Operating expenses	**(696)**	**(4.83)**	(32)	(5.84)
Field netbacks	**1,039**	**7.21**	25	4.57
Other income	**67**	**.46**	123	22.47
General and administrative	**(320)**	**(2.22)**	(77)	(14.06)
Cash netback	**786**	**5.45**	71	12.98
Depletion, depreciation and site restoration	**(621)**	**(4.31)**	(24)	(4.38)
Deferred taxes	**(176)**	**(1.22)**	(28)	(5.11)
Net income (loss)	**$ (11)**	**$ (0.08)**	$ 19	$ 3.49

REVENUE
($000)

REVENUE

Arrival's crude oil and natural gas revenues increased to $1,999,000 in 1998 from $65,000 in 1997 due to a successful 1998 drilling program and a full year of operations compared to the majority of the 1997 production coming onstream in December 1997. During 1998, production revenues consisted of $1,558,000 in crude oil sales and $441,000 in natural gas sales, compared to 1997 revenue consisting entirely of crude oil sales. The average crude oil price received in 1998 was $12.34 per boe compared to $11.87 in 1997. The higher price in 1998 was due to the diversification to light oil in the second half of the year, while all production in 1997 and the first half of 1998 was heavy oil. Oil prices received during 1998 also reflect the decline in West Texas Intermediate prices throughout the year. Oil production during 1998 averaged 346 bbls per day. Natural gas sales realized an average price of $2.45 per mcf on production of 492 mcf per day.

During 1998 Arrival successfully diversified its production profile and by year-end 1998 the Company was producing 45 percent light oil, 35 percent gas and 20 percent heavy oil. Arrival hedged its heavy oil production from November 1, 1998 through October 31, 1999 at a wellhead price of $14 per bbl. The average heavy oil price received during 1998 was approximately $10.35 per boe.

ROYALTIES

Royalties net of ARTC were $264,000 for 1998 compared to $8,000 for 1997. The increase results primarily from higher gross revenues associated with increased production. Royalties as a percentage of production revenue were 13.2 percent in 1998 versus 12.3 percent in 1997. The percentage increase relates to gross overriding royalties on new 1998 wells, as well as the expiry of royalty holiday incentives on high production wells.

OPERATING COSTS

Higher production volumes resulted in operating costs increasing to $696,000 in 1998 from $32,000 in 1997. On a boe basis, operating costs declined 17 percent to $4.83 per boe in 1998 from $5.84 per boe a year earlier. The decrease reflects the economies achieved from high producing wells, prudent cost management, and the construction and operation of an oil treatment facility in the Smiley, Saskatchewan area.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses rose 316 percent in 1998 to $320,000 from $77,000 in 1997 due to increased activity levels and the Company starting operations part way through 1997. On a boe basis, general and administrative expenses fell 84 percent to $2.22 per boe in 1998 from $14.06 per boe in 1997. Included in 1998 general and administrative costs is a one-time interest charge of $87,000 incurred on flow-through expenditures renounced to shareholders in 1997. These flow-through funds were spent on capital projects throughout 1998.

DEPLETION, DEPRECIATION AND SITE RESTORATION

Depletion, depreciation and site restoration expenses increased 2,488 percent in 1998 to $621,000 from $24,000 in 1997, as a direct result of higher production and the increased capital asset base. On a boe basis, the 1998 depletion, depreciation and site restoration is relatively consistent with 1997 at $4.31 in 1998 versus $4.38 in 1997, due to significant reserve additions added in the latter part of 1998.

DEFERRED TAXES

In 1998 the deferred tax provision was $176,000 (1997 - $28,000) due to the renouncement of capital expenditures to our shareholders of approximately $6,465,000 effective December 31, 1998. Arrival has flowed these tax pools to its Class B shareholders, resulting in the Company having tax pools less than the book value of its assets.

Arrival exited 1998 with approximately $3.3 million in tax pools available to reduce future years' taxable income.

CASH FLOW FROM OPERATIONS AND NET EARNINGS

As a result of significant growth in production and sales, cash flow from operations increased 1,007 percent to $786,000 during 1998 from $71,000 in 1997. This growth was achieved despite having a majority of heavy oil production for half the year and a significant reduction in crude oil prices throughout 1998. These factors resulted in a net loss for 1998 of $11,000.

LIQUIDITY AND CAPITAL RESOURCES

Arrival continues to focus on a strong financial position. Ideally the Company will maintain a bank debt level not exceeding an average 1.5 times cash flow. Currently the Company has available a $5,000,000 line of credit.

The key factors affecting Arrival's liquidity are working capital, funds from operations and the availability of bank financing. As Arrival operates the majority of its properties, the Company administers on its own behalf, and for working interest partners, the financial obligations of the Company's properties. Capital spending on these properties is generally offset by cash calls to partners prior to the incurrence of expenditures. Arrival settles receivables and trade payables in accordance with normal industry practices.

At December 31, 1998 Arrival had a working capital deficiency of $1.1 million reflecting its increased drilling and seismic program late in 1998. The 1999 capital budget has been set at $4 million, which will be financed through cash flow and bank financing.

BUSINESS RISKS

All companies in the Canadian oil and natural gas industry are exposed to a number of business risks, some of which are beyond the Company's control. These can be categorized as operational, financial and regulatory risks.

Operational risks include finding and developing oil and natural gas reserves economically, marketing production, hiring and retaining employees and conducting operations in a cost-effective manner. Arrival mitigates these risks by hiring and contracting highly skilled professionals with proven expertise in their field. The Company maintains an insurance program which is consistent with industry practice. Arrival also reduces risk by maintaining an inventory of internally-generated prospects covering both oil and natural gas within strategically selected, core geographic areas, operating joint venture prospects and using leading-edge technology.

Financial risks include commodity prices, interest rates and the Canada/ US exchange rate, all of which are beyond the control of Arrival. The Company manages its exposure to commodity pricing and exchange rate fluctuations through hedges where appropriate. In addition the Company minimizes interest rate risk through the prudent management of cash flow, bank and equity financing.

Arrival is subject to various regulatory risks, many of which are beyond the control of the Company. Arrival takes a proactive approach with respect to environmental and safety matters and also has an operational emergency response plan in place.

YEAR 2000

Arrival has reviewed the implications of the Year 2000 on its operations to ensure that the Company will not be adversely affected. This review included an evaluation of all hardware and software purchased since the Company's inception in 1997. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

Management's Report to the Shareholders

The management of Arrival Energy Ltd. is responsible for the information included in this Annual Report. The financial statements have been prepared in accordance with accounting principles generally accepted in Canada and in accordance with accounting policies detailed in the notes to the financial statements. Where necessary, the financial statements include amounts based on management's informed judgements and estimates. Financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.

Management maintains a system of internal controls to provide reasonable assurance that all of the Company's assets are safeguarded and to facilitate the preparation of relevant, reliable and timely information.

The Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

Andrew W. Kramchynski
President and Chief Executive Officer

Michele Leeners
Controller

Auditors' Report to the Shareholders

We have audited the balance sheets of Arrival Energy Ltd. as at December 31, 1998 and 1997 and the statements of operations and retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG LLP
Chartered Accountants

Calgary, Canada
March 25, 1999

Balance Sheets

December 31, 1998 and 1997		1998		1997
ASSETS				
Current assets				
Cash and short-term investments	$	**937,459**	$	4,035,603
Accounts receivable		**886,705**		403,371
		1,824,164		4,438,974
Property, plant and equipment (note 3)		**6,428,256**		3,120,413
	$	**8,252,420**	$	7,559,387
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities				
Accounts payable and accrued liabilities	$	**2,963,860**	$	871,773
Site restoration provision		**28,400**		700
Deferred income taxes		**87,292**		–
Shareholders' equity				
Share capital (note 4)		**5,165,277**		6,668,032
Retained earnings		**7,591**		18,882
		5,172,868		6,686,914
	$	**8,252,420**	$	7,559,387

See accompanying notes to financial statements.

Approved on behalf of the Board:

Director

Director

Statements of Operations and Retained Earnings

Years ended December 31, 1998 and 1997		1998		1997
Revenue				
Production income, net	$	**1,735,071**	$	57,005
Interest and other income		**66,715**		122,516
		1,801,786		179,521
Expenses				
Production		**696,015**		31,672
General and administrative		**320,120**		77,327
Depletion, depreciation and site restoration		**620,778**		23,640
		1,636,913		132,639
Income before taxes		**164,873**		46,882
Deferred income taxes (note 5)		**176,164**		28,000
Net income (loss)		**(11,291)**		18,882
Retained earnings, beginning of year		**18,882**		–
Retained earnings, end of year	$	**7,591**	$	18,882
Basic earnings per share	$	**0.00**	$	0.00

See accompanying notes to financial statements.

Statements of Changes in Financial Position

Years ended December 31, 1998 and 1997	1998	1997
Cash provided by (used in)		
Operations		
Net income (loss)	$ **(11,291)**	$ 18,882
Depletion, depreciation and site restoration	**620,778**	23,640
Deferred income taxes	**176,164**	28,000
Funds provided from operations	**785,651**	70,522
Net change in non-cash working capital	**101,925**	(81,159)
	887,576	(10,637)
Financing		
Issue of Class A shares	**86,167**	774,000
Issue of Class B shares	**–**	7,626,000
Share issue costs	**(1,587)**	(653,648)
	84,580	7,746,352
Investing		
Property, plant and equipment	**(5,577,128)**	(4,348,673)
Change in non-cash working capital	**1,506,828**	548,561
	(4,070,300)	(3,800,112)
Change in cash and short-term investments	**(3,098,144)**	3,935,603
Cash and short-term investments, beginning of year	**4,035,603**	100,000
Cash and short-term investments, end of year	$ **937,459**	$ 4,035,603

See accompanying notes to financial statements.

Notes to Financial Statements

Years ended December 31, 1998 and 1997

1. INCORPORATION

Arrival Energy Ltd. (the "Corporation") was incorporated under the laws of the Province of Alberta by Articles of Incorporation dated November 12, 1996 as 716175 Alberta Ltd. On January 17, 1997 Articles of Amendment were filed to change the Corporation's name to Arrival Energy Ltd. The Corporation is engaged in the exploration and development of petroleum and natural gas properties.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Property, plant and equipment

The Corporation follows the full cost method of accounting under which all costs associated with the exploration for and development of oil and gas reserves are capitalized. Capitalized costs include lease acquisition costs, the costs of geological and geophysical activities, the costs of drilling both productive and non-productive wells, carrying charges of non-producing properties and overhead costs directly related to exploration and development activities. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets, except when such a disposal would alter the rate of depletion and depreciation by more than 20 per cent, in which case a gain or loss on disposal is recorded.

Depletion of oil and gas properties is calculated using the unit of production method which is based upon gross proven reserve volumes as determined by external reserve engineers. Production facilities are depreciated on a straight-line basis over 15 years useful life. Gas volumes are converted to equivalent oil volumes based upon the relative energy content of six thousand cubic feet of gas to one barrel of oil.

The costs of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. These properties are assessed to determine whether an impairment in value has occurred. When proven reserves are assigned to the property or the property is considered to have an impairment in value, the cost of the property or amount of the impairment in value is added to the capitalized costs for the calculation of depletion.

The cost less accumulated depletion and depreciation, deferred income taxes and the accumulated provision for future site restoration costs ("net capitalized cost") is limited to the sum of the following ("cost ceiling"):

(i) The estimated undiscounted future net revenue (based on prices and costs at the balance sheet date) derived from proved reserves net of financing costs, production related general and administrative costs, future site restoration costs and income taxes; and

(ii) The lower of cost or fair market value of unproved properties.

Future net revenue is calculated using the current Income Tax and the Alberta Royalty Tax Credit legislation throughout the life of the reserves.

A significant portion of the Corporation's exploration, development and production activities are conducted jointly with others, and accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

(b) Flow through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow through share arrangements are renounced to investors in accordance with income tax legislation. Property, plant and equipment, and the stated value of share capital are reduced by amounts equal to the estimated income tax benefits renounced by the Corporation to the investors. This reduction is recorded when the exploration and development expenditures are renounced to investors.

(c) ***Site restoration***

Future site restoration costs are expensed on a unit of production basis. These costs are based on year-end engineering estimates of the anticipated costs of site restoration. Actual expenditures incurred are applied against the future site restoration provision.

(d) ***Income taxes***

The Corporation follows the deferral method of accounting for income taxes.

(e) ***Measurement uncertainty***

The amounts recorded for depletion, depreciation and amortization of property, plant and equipment and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil and natural gas prices and future costs. By their nature, these estimates are subject to measurement uncertainty and may impact the financial statements of future periods.

(f) ***Per share amounts***

Per share amounts are calculated using the weighted average number of Class A and B shares outstanding during the year. At year end, the Class A shares traded at $1.10 per share and accordingly the 762,600 Class B shares would convert to 6,932,727 Class A shares.

3. PROPERTY, PLANT AND EQUIPMENT

	1998		
	Cost	**Accumulated depletion and depreciation**	**Net book value**
Petroleum and natural gas properties	**$ 6,984,374**	**$ 596,056**	**$ 6,388,318**
Office furniture and equipment	**59,900**	**19,962**	**39,938**
	$ 7,044,274	**$ 616,018**	**$ 6,428,256**

	1997		
	Cost	Accumulated depletion and depreciation	Net book value
Petroleum and natural gas properties	$ 3,115,198	$ 21,000	$ 3,094,198
Office furniture and equipment	28,155	1,940	26,215
	$ 3,143,353	$ 22,940	$ 3,120,413

Costs related to acquiring and evaluating unproved properties totaling $1,744,351 (1997 - $778,000) were excluded from the depletion calculation.

As at December 31, 1998, the estimated future abandonment costs to be accrued over the remaining proved reserves totaled approximately $227,000 (1997 - $90,000).

4. SHARE CAPITAL

(a) ***Authorized***

On January 17, 1997 the Corporation filed Articles of Amendment to amend the capital structure and create Class A and Class B shares. Common shares outstanding were canceled and the holders of these shares received one Class A share for each common share held. For purposes of these financial statements, all descriptions of shares issued during 1996 reflect the amended capital structure.

The Corporation has an unlimited number of Class A shares and Class B shares authorized. The Class A shares and Class B shares are voting on the basis of one vote per share. There are no fixed dividends payable on either the Class A or Class B shares. The Class B shares are convertible, at the option of the Corporation, at any time after March 31, 2001 and before March 31, 2003 into Class A shares upon five days prior notice to holders of Class B shares. The number of Class A shares obtained upon conversion of each Class B share will be equal to $10 divided by the greater of $1 and the current market price of the Class A shares. If the Corporation fails to exercise the conversion option by March 31, 2003, then the Class B shares shall be convertible at the option of the shareholder, at any time after April 1, 2003 and before May 1, 2003 into Class A shares. Any Class B shares not converted by May 1, 2003 will be automatically converted into Class A shares at the conversion rate.

The Corporation has also authorized an unlimited number of preferred shares.

(b) Issued and outstanding

	Number of Shares		Amount
Class A shares			
Balance, December 31, 1996	500,000	$	100,000
Issued for cash to directors and officers	1,000,000		200,000
IPO proceeds 8,200 units consisting of 350 shares each	2,870,000		574,000
Balance, December 31, 1997	4,370,000		874,000
Exercise broker warrants	82,000		82,000
Exercise directors' options	8,333		4,167
Balance, December 31, 1998	**4,460,333**	**$**	**960,167**
Class B shares			
IPO proceeds 8,200 consisting of 93 shares each	762,600		7,626,000
Share issue costs	–		(653,648)
Share issue costs - deferred taxes	–		28,000
Flow through share renouncement	–		(1,206,320)
Balance, December 31, 1997	762,600		5,794,032
Share issue costs	–		(1,587)
Share issue costs - deferred taxes	–		88,872
Flow through share renouncement	–		(1,676,207)
Balance, December 31, 1998	**762,600**	**$**	**4,205,110**

During 1997, Arrival issued Class B flow through shares for proceeds of $7.6 million. As at December 31, 1998, the Corporation had incurred qualifying expenditures of $6,465,000 (1997 - $2,700,000) which had been renounced to the shareholders.

(c) Stock options entitling the holder to purchase Class A shares of the Corporation have been granted to directors, officers and employees of the Corporation. At December 31, 1998, options to purchase 381,667 (1997 - 390,000) Class A shares were outstanding, with an exercise price of $0.50 per share. The options vest as to one-third on each of the first, second and third anniversaries of the date of the grant, and expire in year 2002. Pursuant to an Agency Agreement, 164,000 warrants were issued, whereby the holder may exercise the warrants at $1 to acquire one Class A share. At December 31, 1998, 82,000 warrants were outstanding, as 82,000 were exercised during the year at $1. The warrants expire August 1999.

5. INCOME TAXES

The provision for income tax differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate to income before taxes. This difference results from the following:

	1998	1997
Effective tax rate	**44.7%**	44.7%
Computed expected income tax	**$ 73,698**	$ 20,956
Effect on income tax of:		
Resource allowance	**(108,534)**	–
Non-deductible crown royalties, net of Alberta Royalty Tax Credit	**62,785**	1,739
Non-deductible depletion	**146,404**	5,305
Other	**1,811**	–
Income tax expense	**$ 176,164**	$ 28,000

The Corporation has tax pools of approximately $3,290,000 available to reduce future years taxable income. As at December 31, 1998, the net book value of property, plant and equipment exceeds the cost base for income taxes by approximately $3,275,000.

6. FINANCIAL INSTRUMENTS

The Corporation's financial instruments included in the balance sheet include cash, short-term investments, accounts receivable and all current liabilities.

The fair values of financial instruments included in the balance sheet approximate their carrying amount due to their short-term maturity.

7. COMMITMENTS

Office rent

The Company is committed to payments under an office lease agreement as follows:

1999	$ 74,000
2000	25,000

8. CREDIT FACILITY

At December 31, 1998 the Corporation had an unused $2,000,000 revolving operating demand loan facility available for use. Subsequent to December 31, 1998 the amount available under the facility was increased to $5,000,000. The facility bears interest at prime + 1/4 % per annum and is secured by a floating charge debenture, general assignment of book debts and the Corporation's petroleum and natural gas properties and equipment.

9. UNCERTAINTY DUE TO THE YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant system failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

10. COMPARATIVE FIGURES

The presentation of certain accounts of the prior year have been changed to conform with the presentation adopted for the current year.

Corporate Information

BOARD OF DIRECTORS

Andrew W. Kramchynski
President & CEO
Arrival Energy Ltd.

Jason C. Yeon
Vice President, Exploration
Arrival Energy Ltd.

David M. Ewasuik
President
EFA Software Services Ltd.

Richard R. Osler
President
Aequanimitas Ltd.

OFFICERS & SENIOR PERSONNEL

Andrew W. Kramchynski
President & CEO

Jason C. Yeon
Vice President, Exploration

S. Bruce Duncan
Chief Geophysicist

Michele Leeners
Controller

Harley L. Winger
Secretary

STOCK EXCHANGE LISTING

The Alberta
Stock Exchange
Stock Symbols: ARR.A
ARR.B

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